

**STATE OF NORTH DAKOTA
BISMARCK, NORTH DAKOTA**

**PRELICENSING
REPORT OF EXAMINATION**

OF

**QBE SPECIALTY INSURANCE CO.
NEW YORK, NEW YORK**

**AS OF
AUGUST 31, 2002**

STATE OF NORTH DAKOTA
DEPARTMENT OF INSURANCE

I, the undersigned, Commissioner of Insurance of the State of North Dakota do hereby certify that
I have compared the annexed copy of the Report of Examination of the

QBE Specialty Insurance Co.

New York, New York

as of August 31, 2002, with the original on file in this Department and that the same is a correct
transcript therefrom and of the whole of said original.

IN WITNESS WHEREOF, I have hereunto
set my hand and affixed my official seal at my
office in the City of Bismarck, this _____ day of
_____, 2002.

Jim Poolman
Commissioner of Insurance

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Bismarck, North Dakota
September 23, 2002

Honorable Jim Poolman
Commissioner of Insurance
North Dakota Department of Insurance
600 East Boulevard Ave, Dept 401
Bismarck, ND 58505

Commissioner Poolman:

Pursuant to your instructions and statutory requirements, a prelicensing examination as of August 31, 2002, has been made of the financial condition and affairs of

QBE Specialty Insurance Co.
314 East Thayer Avenue
Bismarck, North Dakota 58501

hereinafter referred to as the "Company," at its administrative office and place of business located at:

Wall Street Plaza
88 Pine Street
New York, NY 10005

The following report is respectfully submitted.

INTRODUCTION

This prelicensing examination was conducted by examiners from the North Dakota Insurance Department for the purpose of determining that the Company has complied with the requirements of the law according to the nature of the business proposed and is authorized to do business in the State of North Dakota. This examination was conducted in conformance with methods established by the National Association of Insurance Commissioners and included such tests of the Company's accounts and records and proposed plan of operation as deemed necessary under the circumstances.

SCOPE OF EXAMINATION

The examination consisted of a review of the Company's Articles of Incorporation and Bylaws, a verification of assets, liabilities, and surplus, and a general inquiry into the operational practices of the Company and its parents. The extent to which these items were verified is disclosed in the following narrative.

HISTORY

The Company was incorporated on August 5, 2002, under N.D. Cent. Code Chapter 10-19.1, the North Dakota Business Corporation Act, and N.D. Cent. Code Chapter 26.1-05, Organization and Operation of Domestic Companies. The Company's primary purpose is to engage in the business of property and casualty insurance. The Company is a wholly-owned subsidiary of QBE Insurance Group Limited, a publicly traded corporation, and QBE Insurance Corporation, an insurance company domiciled in Delaware as of the date of this examination.

The Company's Articles of Incorporation provide that:

- The Company will operate on the stock plan.
- The Company's fiscal year will be a calendar year
- The Company's existence will be perpetual.

CAPITALIZATION

The Company is authorized to operate on the stock plan. The aggregate number of shares, which the Company has authority to issue, is 500,000 shares of common stock with a par value of \$1.00 per share.

The Board of Directors approved the issuance of 500,000 shares at a purchase price of \$1.00 per share to the Company's immediate parent, QBE Insurance Corporation. The immediate parent transferred funds totaling \$15,000,000 to the Company's bank account on August 28, 2002, attributable to the common stock purchase and a paid-in surplus contribution of \$14,500,000.

N.D. Cent. Code § 26.1-05-04 requires at least \$500,000 of authorized capital stock and \$500,000 of surplus in order for a domestic stock company to be formed under the insurance laws of North Dakota. The common stock provisions authorized in the Company's Articles of Incorporation along with the paid-in contribution satisfy the statutory requirement.

MANAGEMENT AND CONTROL

Stockholders

The Company, as defined in its Bylaws, is owned by the stockholders. QBE Insurance Corporation is the owner of 100% of the Company's outstanding stock.

The annual meeting of the stockholders is to be held on the second week of March of every year at such date and time as is designated by the Board of Directors.

Directors

The Bylaws provide that the business of the corporation will be managed by or under the direction of a Board of Directors, which will consist of not less than seven directors. Each director will be elected at the annual stockholders meeting and will hold office until a successor has been elected and qualified. Directors need not be shareholders.

The directors serving at the date of this examination were as follows:

<u>Name and Address</u>	<u>Principal Occupation</u>
Frances M. O'Halloran East Balmain, Australia	Chairman, QBE Insurance Group Limited
Ian G. Davey Maplewood, NJ	Senior VP, QBE Reinsurance Corporation and QBE Insurance Corporation
James J. Fiore Bardonia, NY	Executive VP and Chief Underwriting Officer, QBE Reinsurance Corporation and QBE Insurance Corporation
John C. LaCava Rockville Centre, NY	Senior VP and Chief Information Officer, QBE Reinsurance Corporation and QBE Insurance Corporation
Anthony R. Przybyszewski Brooklyn, NY	Senior VP, Chief Administrative Officer and Secretary, QBE Reinsurance Corporation and QBE Insurance Corporation
Timothy M. Kenny Northport, NY	President & Chief Executive Officer, QBE Reinsurance Corporation and QBE Insurance Corporation
John R. Ferrara Merrick, NY	Senior VP and Chief Actuary, QBE Reinsurance Corporation and QBE Insurance Corporation
Christopher C. Fish Hillsdale, NJ	Senior VP, Chief Financial Officer & Treasurer QBE Reinsurance Corporation and QBE Insurance Corporation
Alan J. Levin West Hartford, CT	Attorney At Law, Edwards & Angell, LLP

Officers

The Company's officers are elected by the Board of Directors and will include a president, a vice president, a secretary, and a treasurer. The directors may also elect additional vice presidents and assistant officers as deemed necessary. Any two or more offices may be held by the same person except that the offices of president and secretary may not be held by the same person.

Officers designated as of the date of this examination are as follows:

Francis M. O'Halloran	Chairman
Timothy M. Kenny	President & Chief Executive Officer
James J. Fiore	Executive Vice President and Chief Underwriting Officer

Anthony R. Przybyszewski	Senior Vice President, Chief Administrative Officer and Secretary
Christopher C. Fish	Senior Vice President, Chief Financial Officer and Treasurer
John C. LaCava	Senior Vice President and Chief Information Officer
John R. Ferrara	Senior Vice President and Chief Actuary
Ian G. Davey	Senior Vice President

COMMITTEES

Directors serving on committees that were established by the Board are as follows:

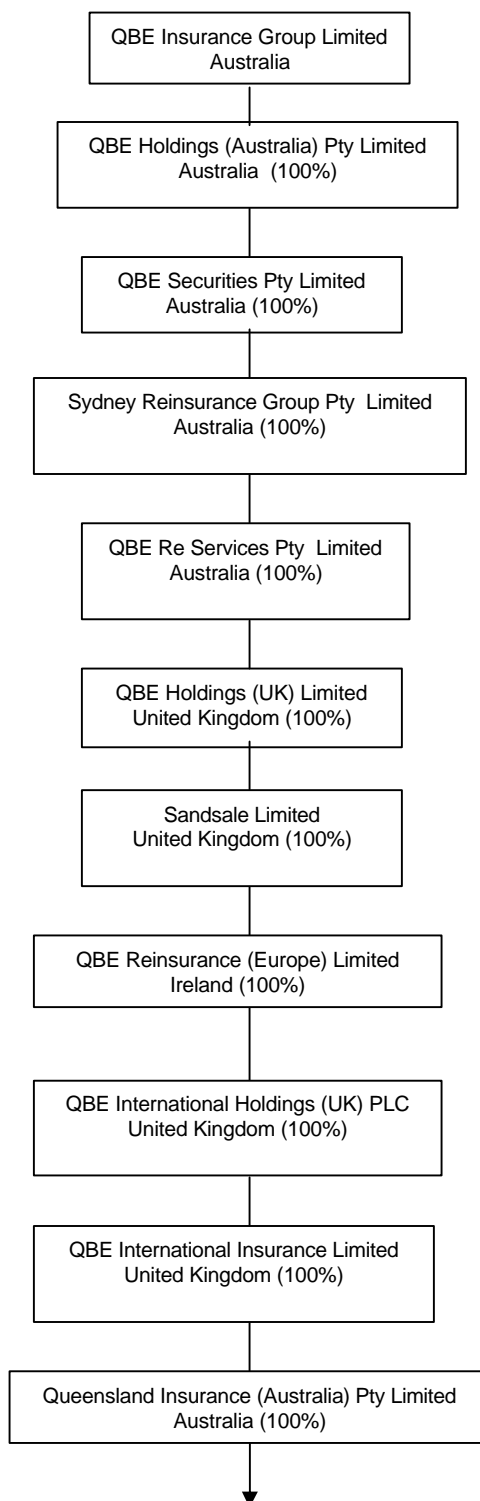
<u>Executive Committee</u>	<u>Audit Committee</u>	<u>Conflict of Interest Committee</u>
Francis M. O'Halloran Tim M. Kenny	Timothy M. Kenny John R. Ferrara Christopher C. Fish	Tim M. Kenny Alan J. Levin Anthony R. Przybyszewski

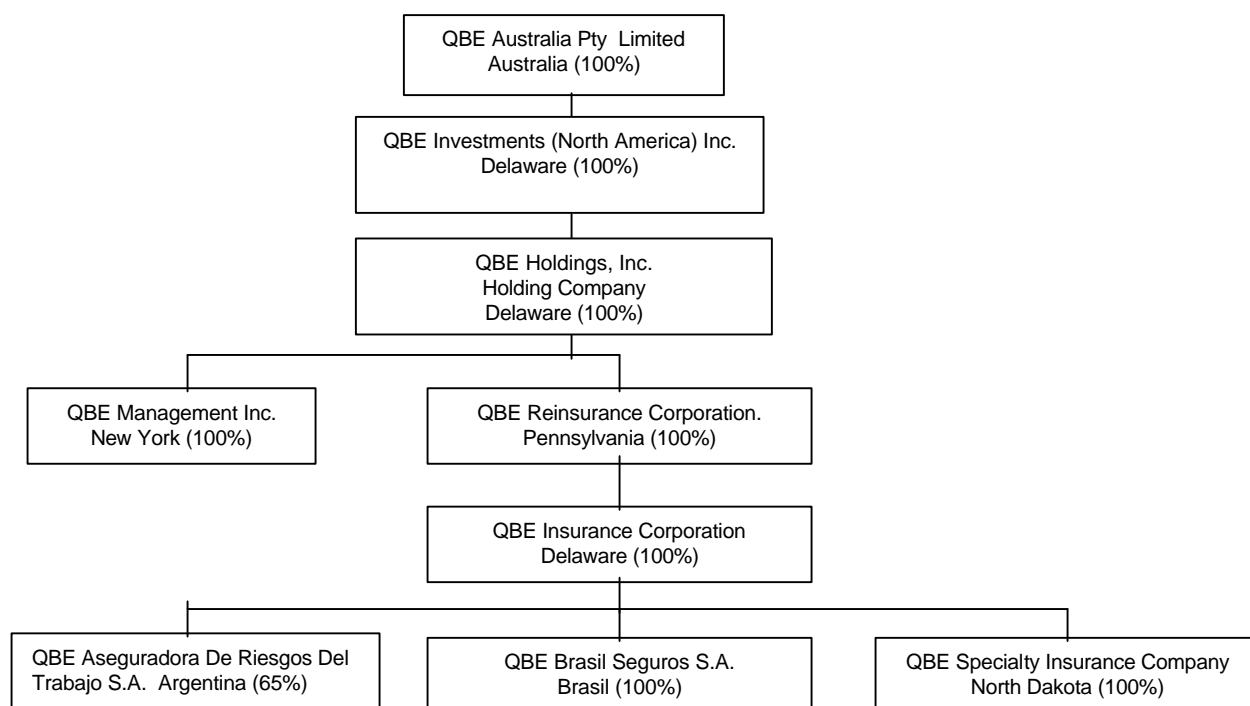
Conflict of Interest

The companies of the QBE Group have develop a Code of Conduct as a reference guide to help officers and staff members understand appropriate standards of business conduct and to establish compliance requirements. The companies have also established procedures for the disclosure of possible conflicts of interest. In conjunction with the annual board meeting, all directors and senior management are asked to review the Code of Conduct and complete and sign a conflict of interest questionnaire.

ORGANIZATIONAL CHART

The Company is a member of an insurance holding company system. The relationship of the Company to its parent and affiliates is shown in the following organization chart which is limited in its presentation to the Americas holding company system and its upstream ownership structure:





PARENT COMPANIES

QBE Insurance Group Limited, the ultimate controlling entity, is a publicly traded insurance holding company incorporated in Australia with shares traded on the Australian Stock Exchange. The QBE group of companies transacts general insurance and reinsurance operations on a worldwide basis. The home and administrative office of this entity is located at 82 Pitt Street, Sydney, NSW 2000, Australia. No individual holds more than 10% of any class of voting security in QBE Insurance Group Limited.

QBE Holdings, Inc. is incorporated in Delaware and is the intermediate holding company for the Group's insurance operations in the Americas.

QBE Reinsurance Corporation was incorporated and commenced business under the laws of the State of Pennsylvania in 1964. It was acquired by the QBE Group in 1993 and subsequently its name was changed to Sydney Reinsurance Corporation. Its present name was adopted in 2001. At December 31, 2001, QBE Reinsurance Corporation reported total capital and surplus of \$201,525,655 and total admitted assets of \$547,222,672.

QBE Insurance Corporation is the Company's immediate parent and a Delaware domiciled insurer through the date of this examination (see Subsequent Events below). It was originally incorporated in 1980 and was acquired by the QBE Group in 1992. This company was renamed Melbourne Reinsurance Company in 1993 and, in 1997, the entity's name was changed to QBE Insurance Corporation. This parent writes direct insurance business on a program basis through managing general agents in select lines of business including private passenger, commercial auto, other liability, commercial multiple peril, fire, surety, credit, and group accident and health. At December 31, 2001, QBE Insurance Corporation reported total capital and surplus of \$49,596,356 and total admitted assets of \$126,158,806.

INTERCOMPANY TRANSACTIONS

Service Agreement

A proposed Service Agreement has been approved by the Insurance Department under which QBE Reinsurance Corporation and QBE Insurance Corporation will provide office space, facilities, and administrative services to the Company including claims adjustment and investigation, underwriting and processing, customer service, policy issuance, record keeping, accounting and investment, actuarial, and other services as may be requested by the Company. The Agreement provides for the Company's share of costs to be determined based on an actual time spent analysis method and actual expenses. The Company must remit any amounts due within 90 days of its receipt of the monthly expense report. The Agreement continues until such time as the parties mutually agree in writing to terminate the agreement or it may be terminated with or without cause by either party giving 60 days written notice.

Group Investment Division (GID) acts as investment manager through QBE Management Services Pty Limited to the QBE Reinsurance Corporation, QBE Insurance Corporation, and the Company. Pursuant to written provisions and general investment guidelines, GID manages the investment portfolios of the companies on a fully discretionary basis.

Tax Sharing Agreement

The Company will file federal income tax returns on a consolidated basis with its upstream parent, QBE Investments (North America) Inc. and affiliated companies within the QBE Americas group in accordance with a Tax Sharing Agreement dated August 8, 2002. Under the Agreement, the federal income tax liability of each affiliated entity is determined as if each had filed separate federal income tax return for the calendar year.

FIDELITY BOND

A fidelity bond is issued to QBE Reinsurance Corporation that provides coverage in the amount of \$2,000,000 for the named insured and including all subsidiaries.

PENSION AND RETIREMENT PLANS

QBE Reinsurance Corporation sponsors a defined benefit pension plan covering substantially all full-time employees of QBE Reinsurance Corporation, QBE Insurance Corporation, and the Company who have fulfilled minimum age and service requirements. The Group's funding and accounting policies are to contribute annually an amount that is between the minimum required under ERISA and the maximum deductible for federal income tax purposes.

The affiliated group also has a 401K retirement plan and matches up to two-thirds of eligible employee contributions up to 6% of eligible compensation. The companies' contribution is expensed in the same period as the employee contribution.

STATUTORY DEPOSIT

At August 31, 2002, the Company maintained a \$1,000,000 certificate of deposit with the Bank of North Dakota that is pledged to the North Dakota Insurance Commissioner for the benefit of all policyholders.

TERRITORY AND PLAN OF OPERATION

The Company proposes to be a domestic licensed insurer in North Dakota writing specialty lines of property and casualty business as an approved surplus lines carrier in all other states.

The initial business plan is to utilize the production, underwriting, servicing, and claims processing resources of various general agencies and managing general agents (GA/MGA) to write primary insurance under program proposals submitted by the agencies. Such program proposals will be evaluated by the Company's management for consistency with its pre-established underwriting guidelines and business objectives. Approved programs will be subject to ongoing supervision by the Company under a system of monthly reporting procedures and a minimum of semi-annual audits of each GA/MGA.

The compensation for each approved program will be individually negotiated with the GA/MGA and will consist of a pre-agreed commission allowance to cover the GA/MGA's basic expenses along with a contingent commission available based on a pre-described formula.

Under a Service Agreement with its immediate parents, the Company will require the resources of the parent's corporate accounting, actuarial, claims, legal, regulatory, and systems services to evaluate, administer, and supervise the book of business generated by the GA/MGA programs.

The Company intends to reinsure its program risks on an 80/20 Quota Share basis with its parent, QBE Reinsurance Corporation.

REINSURANCE

There were no reinsurance arrangements in effect as of the date of this examination. The Company must submit its reinsurance treaties to this Department for approval prior to implementation.

FINANCIAL STATEMENT

As of August 31, 2002

ASSETS

Common Stock	\$ 9,500,000	
Cash	1,000,000	
Short Term Investments	<u>4,500,000</u>	
Total Admitted Assets		<u>\$ 15,000,000</u>

LIABILITIES AND OTHER FUNDS

Liability for Start-up Costs	\$ 25,000	
Common Capital Stock	500,000	
Gross Paid in & Contributed Surplus	14,500,000	
Unassigned Funds	<u>(25,000)</u>	
Total Liabilities, Surplus and Other Funds		<u>\$ 15,000,000</u>

FINANCIAL COMMENTS

Common Stock \$ 9,500,000

The Company holds a \$9,500,000 investment in Brown Brothers Harriman Money Market Fund at August 31, 2000, that is classified as common stock pursuant to the *Purposes and Procedures Manual of the NAIC Securities Valuation Office*.

Short-Term Investments \$ 4,500,000

Short-term investments consist of various corporate commercial paper drawing from 1.73% to 1.78% interest.

Liability for Start-up Costs \$ 25,000

The Company estimated start-up costs totaling \$25,000. Any difference between the estimated and the actual amount is not expected to have a material effect on the Company's surplus position.

CONCLUSION

Based on the preclicensing examination conducted as of August 31, 2002, the financial condition of QBE Specialty Insurance Co. was found to be as follows:

Assets	<u>\$ 15,000,000</u>
Liabilities	\$ 25,000
Capital and Surplus	<u>14,975,000</u>
Total Liabilities, Surplus & Other Funds	<u>\$ 15,000,000</u>

N.D. Cent. Code § 26.1-05-04 requires a domestic stock company to have at least \$500,000 of authorized capital stock and \$500,000 of surplus in order to incorporate under the insurance laws of North Dakota. The results of this examination indicate that the Company meets the capital and surplus requirements of the North Dakota Insurance Code. No exceptions to state law were noted.

The examiner expresses her appreciation for the assistance and cooperation extended by the officers and employees of the Company and its affiliates.

Respectfully submitted,

Carole Kessel, CPA
Chief Examiner
N.D. Insurance Department

SUBSEQUENT EVENTS

By resolution dated September 11, 2002, the Company's Board of Directors authorized a name change to QBE Specialty Insurance Company along with corresponding amendments to the Articles and Bylaws.

The Company's immediate parent, QBE Insurance Corporation, redomesticated from Delaware to Pennsylvania on September 5, 2002.